

CYPRUS TAX

INTRODUCTION

The main principles in the tax legislation of Cyprus are:

- The taxation of companies is based on tax residency. Companies will be considered resident in Cyprus and taxed in Cyprus if they are managed and controlled in Cyprus;
- Participation exemption for dividends received from other companies;
- No withholding tax on dividends, interest and royalties payable to non-residents (foreign companies and individuals);
- The corporate rate is 12.5%;
- The term “resident” has been added to the vocabulary of relevant terms under the new taxation system. For corporate entities, as mentioned above, the criteria are management and control. As far as physical persons are concerned, an individual who stays in Cyprus for a period or periods exceeding in aggregate 183 days in the year of assessment is considered resident in Cyprus;
- Tax liability is based either on residence (worldwide income for residents) or on Cyprus source income only for non-residents. Incorporation of the Company per se is no longer a criterion establishing residence in Cyprus.

PERSONAL INCOME TAX

An individual is considered to be resident in Cyprus if he spends 183 days or more in Cyprus.

Residents

Residents are taxed on income from:

- profits from trade vocation or profession;
- rents, royalties and pensions;
- remuneration and benefits from employment;

CYPRUS TAX

- profit from sale of goodwill.

Non-residents

Non-residents are taxed on income including:

- rental income from immovable property in Cyprus;
- profit of a business carried out through a permanent establishment in Cyprus;
- remuneration from employment exercised in Cyprus.

The following rates apply to individuals for 2011:

Taxable Income

Taxable Income	Taxable Rate	Sum of Tax	Accumulated Tax
€	€	€	€
0 – 19.500	0%	0	0
19.500 – 28.000	20%	1.700	1.700
28.001 – 36.300	25%	2.075	3.775
36.301 – 60.000	30%	7.110	10.885
60.001 – and above	35%		

As from 1st January 2003 foreign employees and Cypriot employees are treated in the same manner.

However, expatriates will get a 20% deduction from their salaries for their first three years in Cyprus, limited to €8,543 as compensation for their costs to be established in Cyprus. This deduction is first claimed in the tax year following the year of their arrival to Cyprus.

Also expatriates will get 50% deduction from remuneration from any employment exercised in Cyprus, exemption applies for a period of 5 years for employments commencing as from 1 January 2012 provided that the annual remuneration exceeds EUR 100.000.

CYPRUS TAX

Contributions to social insurance, approved provident funds, approved medical funds or pension schemes and life insurance premiums are deductible with some restrictions.

Expatriate employees of International Business Companies

Expatriate employees of IBCs are taxed according to the tax residency criteria, set at 183 days therefore:

- if they are employed in Cyprus for 183 days or more they are taxed on all employment income; However, an exemption applies in respect of the remuneration for services rendered to a permanent establishment abroad of a resident employer, or to a non-resident employer and the aggregate period of visits abroad must not be less than 90 days in the year of assessment;
- if they are employed in Cyprus for less than 183 days then tax is payable on the salary attributable to their employment in Cyprus;
- if they are employed outside of Cyprus then no tax is payable;
- if they are employed in Cyprus they will be subject to social security contributions

CORPORATE TAX

Corporate Tax Rate is 12.5% on the Net Profit.

Cyprus branches of foreign companies are also subject to 12.5% tax on their worldwide income if the management and control of the branch is performed in Cyprus. If the management and controlled is not performed in Cyprus, then all the income will be exempt from Cyprus tax.

Non-resident companies will be liable to corporate tax on their profits which have accrued or arose in Cyprus from a permanent establishment (PE) in Cyprus.

Income exempt from taxation

Subject to certain conditions the following are exempt from taxation:

- Dividends from Cyprus or abroad;

CYPRUS TAX

- Profits arising from the disposal of shares and securities;
- Profits arising from an overseas permanent establishment.

DIVIDENDS

Dividends received by a Cyprus resident company from another Cyprus resident company are exempt from taxation. Also, dividends received by a Cyprus resident company (or a permanent establishment of a non-resident company) from a foreign entity are generally exempt from taxation in Cyprus in accordance with EU Parent-Subsidiary Directive and the provision of Cyprus legislation. This gives Cyprus a real advantage over other European holding company regimes which generally impose a withholding tax, even when reduced by a double taxation treaty, of at least 5%.

The exemption does not apply where the foreign entity:

- (a) Receives more than 50% of its income from investment activities, and
- (b) The foreign tax burden of the company paying the dividend is substantially lower than that of the Cyprus resident company.

The Cyprus Tax Authorities have acknowledged that foreign tax burden does not cover only the tax paid by the company paying the dividend but includes also the tax paid by lower level subsidiaries. In practice, therefore, dividends received from subsidiaries or associates are rarely taxed.

Where dividends do not satisfy the requirements for exemption from taxation then they are subject to defence tax at the rate of 17%. However, any tax withheld at source is allowed as a deduction from this tax even if it is made from a country that does not have a double tax treaty with Cyprus.

A tax credit will be afforded according to the Double Taxation Agreements concluded by Cyprus. In the absence of such an agreement, Cyprus unilaterally affords a credit for the foreign tax paid on such income. The underlying tax credit is also available for dividends received from EU member states.

INTEREST INCOME

Interest will be subject to corporate tax at the rate of 12.5% in cases where the interest income is derived in the ordinary course of business or it is closely related with that business. As a general principle, interest earned by banks, financial companies, hire purchase companies or leasing companies is considered to arise from the ordinary course of business.

CYPRUS TAX

1) Interest earned as detailed below is considered to be closely related to that business and is also subject to corporation tax:

- businesses such as car dealers, property developers that sell their products on extended payment terms and charge interest on their trade debtors;
- interest on current account balances at banks;
- interest earned by companies which act as a vehicle through which a group finances the operations of companies within it .

2) In all other cases, where the interest is considered to arise outside the ordinary course of business then is subject to defence tax at the rate of 30%. Interest on deposit accounts and interest earned on loans granted to third parties are treated in this way.

A credit is provided against the defence tax payable for any taxes withheld at source, irrespective of whether a double treaty exists or not.

Collective Investment Schemes (CIS) pay defence tax at a reduced rate of 3% on deemed distributions, whether in respect of income or on liquidation (redemption of units in CIS are exempt).

ROYALTIES

Gross amount of royalties from sources within Cyprus by a company which is not a tax resident of Cyprus are liable to 12.5% withholding tax at source, subject to relief under any applicable double taxation treaty. If the intangible property right however is granted to a Cyprus company for use outside Cyprus, then there is no withholding tax and the corporate rate is applied only on the profit margin left in the Cyprus Company.

CAPITAL GAINS TAX

Gains from the disposal of immovable property situated in Cyprus and of shares of unlisted companies owing immovable property in Cyprus are taxable at a rate of 20%, subject to certain exemptions and reliefs. All other gains are exempt.

CYPRUS TAX

MERGERS AND RE-ORGANISATIONS

The provisions of the Merger Directive will be “extended” to any merger or re- organisation involving a Cypriot tax payer with favorable tax treatment to facilitate transfer of assets and tax losses exception from capital gains tax and transfer fees.

Losses incurred prior to the merger will be allowed to be carried forward by the new company.

OVERSEAS PENSIONS

The pension of any individual for services rendered outside Cyprus is exempt up to €3,417 and any excess is taxable at a flat rate of 5%. For this to apply the person must be resident in Cyprus.

2 Companies are deemed to be members of a group if one is the 75% subsidiary of the other or both are 75% subsidiaries of a third company.

RENTS

Rents are subject to Special Defence Contribution tax at a rate of 3% on the 75% of the gross rent. Companies and partnerships paying rent are required to withhold the tax and pay it to the local tax authorities.

CONCLUSION

Bearing in mind all advantages and benefits of Cyprus’ accession to the European Union, there are a number of factors, which explain the popularity of Cyprus as a jurisdiction attracting foreign investment. These include the following:

- a tax rate which is still attractively low;
- a dividend receivable exemption system rather than the credit system which made Cyprus a prime location for holding companies;

CYPRUS TAX

- corporate groups satisfying a 75% holding are able to benefit from group relief allowing the transfer of losses between members of the group, subject to certain conditions;
- payments of dividends, interest and royalties to non-residents whether or not in a tax treaty jurisdiction are exempt from withholding tax;
- no taxation on profits generated from the disposal of securities for individuals and companies resident in Cyprus; (Please see below the circular by the Inland Revenue for the definition of “securities”)
- exemption from capital gains tax on capital gains realised on immovable property held outside Cyprus;
- exemption (subject to certain conditions) from corporate tax for profits earned from a permanent establishment abroad;
- access to DTTs ;
- access to the EU Directives and exemption from taxation for any reorganisations, mergers, acquisitions and amalgamations of companies.

The provisions governing tax residence, group relief, profits from permanent establishments abroad and dividends receivable need to be considered in order to effectively carry out the requisite tax planning which will optimise the returns of the business in question.

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained.